

**TO: THE CHIEF EXECUTIVE OR MANAGING OFFICER AND
CHAIRMAN OF THE SUPERVISORY COMMITTEE OF ALL
LOUISIANA STATE-CHARTERED CREDIT UNIONS**

FROM: SID SEYMOUR, CHIEF EXAMINER

DATE: SEPTEMBER 30, 2006

RE: LOUISIANA OFFICE OF FINANCIAL INSTITUTIONS (LOFI) - UPDATE

Overall Financial Condition -- Following the one year anniversary of Hurricanes Katrina and Rita, a vast majority of state-chartered credit unions remain in sound financial condition. As of June 30, 2006, there were 53 state-chartered credit unions in Louisiana. As of that date, 88% had a composite CAMEL rating of 1 or 2, compared to 81% as of June 30, 2005. Credit unions experienced upgrades primarily in the asset quality, management, and earnings components, and downgrades primarily in the capital component. While examination results for those credit unions significantly affected by the storms have been generally positive and reflect favorably on management and the Board of Directors, the short-term economic impact has been significant in some cases. Due to the strong capital position of the affected credit unions and the aggressive manner in which management addressed the challenges caused by the storms, any lingering problems appear manageable at this time. The affected credit unions also remain firmly committed to serving their members in their time of greatest need.

Proposed Residential Group Common Bonds and Associational Groups – The LOFI intends to publish a Notice of Intent of Rule Making regarding Residential Group Common Bonds and Associational Groups in the **November 20, 2006, Louisiana Register**. This rule, which is **subject to a 90 day comment period**, will provide guidance regarding residential and associational group common bonds which are authorized, but not defined, in the statutes. A single municipality or parish may qualify as a small community. However, the applicant will be required to demonstrate, as a part of the expanded authority to serve a larger geographic area, their willingness and ability to serve individuals residing in low income areas of the small communities that have insufficient access to affordable (or non-predatory) financial services. As of 6-30-06, 1,016 out of 1,970 licensed finance companies in the state (approximately 52%) engaged in some form of payday lending.

The rule also contains language that is intended to provide clarity as to what constitutes an association for purposes of the Louisiana Credit Union Law (LCUL). Specifically, an association **must** be a separate legal entity that maintains its own financial records. Other factors that will be considered when assessing an application to add an associational group to a credit union's field of membership include but are not limited to the following: participating in specific activities, sharing of common goals, possessing a charter, conducting periodic meetings, paying dues, and sponsoring other activities.

We believe that the geographic expansion authority in the proposed rule, coupled with the ability to **retain** your existing field of membership, the authority to establish maximum interest rates that **can** exceed those of federally-chartered credit unions, the benefit of local supervision, LOFI's nationally-recognized accreditation through the National Association of State Credit Union Supervisors (NASCUS), and broad parity statutes, will improve the attractiveness of the state charter.

Review of the ALLL Account -- On June 26, 2002, the NCUA issued Letter No.: 02-CU-09 concerning the Allowance for Loan and Lease Losses. Attached to the letter was an Interpretive Ruling and Policy Statement (IRPS) on Allowance for Loan and Lease Losses (ALLL) Methodologies and Documentation for Credit Unions. The IRPS requires that credit unions apply GAAP in establishing a well-documented ALLL. As part of our routine examination procedures, examiners will review methodologies for compliance with the IRPS. We have recently completed meetings at which we provided additional guidance and training to our examination staff concerning the Allowance for Loan and Lease Losses (ALLL), concentrating on what constitutes adequate methodologies and mitigating factors. If a credit union does not correctly apply GAAP, or does not properly document and substantiate the need for its recorded ALLL balance, examiners have been instructed to communicate the need to become compliant with the policy statement. Examiners will also suggest that you meet with your CPAs to establish an ALLL in accordance with the IRPS and GAAP.

We understand and share your desire to maintain a strong ALLL account. We are simply asking that you support the ALLL with documentation that demonstrates that the amount is appropriate. In addition to historical loss experience, credit unions should consider (and document) a number of factors in estimating the amount of probable impairment in their loan portfolios resulting from current events existing prior to the issuance of the financial statements. Factors include, but are not limited to, the following: changes in (1) underwriting standards or lending procedures and policies; (2) charge-off and recovery practices; (3) national and local economic and business conditions; (4) the nature and volume of loans; (5) trends in volumes of past due and classified loans; (6) the quality of a credit union's loan review system and degree of oversight by its Board of Directors; (7) the levels and concentrations of loans; and (8) external factors such as competition and legal and regulatory requirements on borrowers. NOTE: GAAP does not allow credit unions to increase the ALLL for future events, such as future hurricanes. The ALLL should only provide for estimated losses that have occurred from a current or prior period. Please contact Staff CPA Mrs. Dale Jacobs at 225/922-0632 or by email at djacobs@ofi.louisiana.gov if you have any questions in this regard.

Role of Supervisory Committees -- Our examiners have recently been provided additional training on the important role of Supervisor Committees and are ready to discuss the best practices with your credit union's Supervisory Committee at upcoming examinations. We will also review significant examination findings or deficiencies in the internal or external audit process with the Supervisory Committee, or the Chairman of the Supervisory Committee, at a minimum. As part of this focus, we will continue to review internal controls and policies and procedures regarding the operation of your credit union.

2006 Regular Legislative Session -- You can find a complete list of industry-related legislation which was enacted during the 2006 Regular Legislative Session on our website at www.ofi.louisiana.gov. The short summaries are meant to inform you of the general contents of the legislation and should not be relied upon in lieu of a complete reading of each act. In order to read the Act in its entirety, simply go to our website and click the link "Index of Acts from the 2006 Legislative Session" which is located under "What's New at OFI." This link is permanently located under the "Statutes" section of our website. Click on "Statutes" on the left menu bar and then click on the link "Index of Acts from the 2006 Legislative Session." The enrolled bills can also be found at the Legislature's website at: www.legis.louisiana.gov. Please contact General Counsel Sue Rouprich at 225/922-1028 or by email at srouprich@ofi.louisiana.gov with any questions.

Credit Union Service Organizations -- As a reminder, state-chartered credit unions may invest in and make loans to credit union service organizations (CUSOs) in accordance with LAC 10:IX.301 and 303. This rule was originally published in 1994, and may found within Title 10 of the Louisiana Administrative Code at <http://www.state.la.us/osr/lac/10v01/10v01.pdf>. Please contact Deputy Chief Examiner John Fields at 225/922-0633, jfields@ofi.state.louisiana.gov with any questions regarding the contents of the rule.

Unrelated Business Income Tax Update – For more than a decade, the state credit union system, through the National Association of State Credit Union Supervisors (NASCUS), has been challenging the Internal Revenue Service (IRS) on its interpretation of what income, if any, earned by state-chartered credit unions should be subject to federal taxation under the provisions of the Internal Revenue Code (IRC) Section 511-513. This section declares that certain tax-exempt organizations under IRC Section 501(c) must pay federal income tax on net income realized from sources that are not substantially related to the tax exempt purpose of the organization. Such income is deemed “unrelated business income” and, therefore, taxable. Reportedly, the IRS is proposing to issue technical advice memorandums (TAMs) that will state that income from insurance sales, including credit life and credit disability, and certain non-member ATM fees (except for non-member ATM fees generated from members of other credit unions using credit union-owned ATMs) is unrelated business income. Although the TAMs were expected to be issued in the first half of 2006, they have not yet been issued.

Other income sources may also be determined by the IRS to be substantially unrelated to a credit union’s exempt purpose. **However, it is important to note that, due in large part to the efforts of NASCUS, the IRS has already determined that income derived from credit and debit card interchange fees, sales of checks, and ATM fees from members are part of the intrinsic operation of a state-chartered credit union and not subject to federal income taxation.** We will continue our efforts to narrow the scope of the TAMs on your behalf through NASCUS. In the meantime, in assessing your potential tax liability for income that may be deemed by the IRS to unrelated business income, you should be aware that appropriate expense allocation **will reduce** the amount of income that is subject to taxation.

Congressional Data Collection Initiative – The House Ways and Means Committee is looking into how consumers benefit from credit unions’ tax-exempt status. As a result, we will be contacting five (5) state-chartered credit unions, in the very near future, to begin gathering data requested by the Committee. We will be using an online questionnaire and a software program with geocoding to respond to questions in the following areas: income characteristics of members; executive compensation; unrelated business income; and CUSOs. It is my understanding that the NCUA has already collected this data in a representative sampling of federally-chartered credit unions on a nationwide basis but has not yet submitted its report.

Information on the National Association of State Credit Union Supervisors’ (NASCUS) Website – It would certainly benefit you to periodically check out the NASCUS website at <http://www.nascus.org>. Their website provides information and updates on the most current matters affecting state-chartered credit unions. The Regulatory Affairs Section (<http://www.nascus.org/regulatory.html>) contains details on proposed rules and requests for comments that may affect state-chartered credit unions. The Legislative Affairs Section (<http://www.nascus.org/legislative.html>) provides information and NASCUS’ commentary on proposed federal legislation that may affect state-chartered credit unions. Generally, NASCUS comments only on federal legislation that may affect the dual chartering system, state-chartered credit unions, share insurance requirements, or infringe upon state regulatory authority. Please contact Deputy Chief Examiner John Fields at 225/922-0633, or jfields@ofi.louisiana.gov with any questions about NASCUS, its website, accessing the information, or understanding the purpose and intent of the various issuances and/or proposals.

Money Services Businesses (MSBs) -- As a reminder, you are responsible for verifying that a MSB has met state licensing requirements and is registered with FinCEN. You may verify that an MSB is registered with FinCEN by obtaining a copy of the filing directly from the MSB or checking the status online at www.msb.gov. Of MSBs, OFI licenses money transmitters and check cashers, but we have different requirements for licensure than the FinCEN requirements for registering as a MSB. The key requirement for

being a MSB is that at least one transaction for dealing in the exchange of currency, cashing checks, or issuing, selling, or redeeming traveler's checks, money orders, or stored value exceeds \$1,000. The state licensing requirements for money transmitters and check cashers are discussed below:

- **Money Transmitters** -- In accordance with LSA 6:1033, a license is required for any person engaging in the business of selling or issuing payment instruments, selling or issuing stored value, or receiving money or monetary value for transmission, including electronic transmission. Exemptions from this license are listed in LSA 6:1034 and include federally insured banks, thrifts, and credit unions, agents of a licensee, such as Western Union or American Express, or a governmental agency. A list of licensed money transmitters is maintained on our website at www.ofi.louisiana.gov, which may be accessed by clicking on the "Sale of Checks" key in the left margin, under "DEPOSITORY," then on the "List of Active Sale of Checks Licensees." In a previous update, you were advised that the supervision and regulation of money transmitters was transferred to the depository division. However, the primary contact persons have changed in this area. If you have any questions regarding these licensees, please contact Review Examiner Doug Buras at (225) 922-2595 or by email at dburas@ofi.louisiana.gov or Administrative Specialist Donna Montagnino at (225) 925-4483 or by email at dmontagnino@ofi.louisiana.gov.
- **Check Cashers** -- Check cashers are also licensed by this office as required by LSA 6:1003 when a fee of more than \$2.00 is charged to cash a check, draft, money order, or other commercial paper. A list of licensed check cashers is maintained on our website at www.ofi.louisiana.gov, which may be accessed by clicking on the "Check Cashers" key in the left margin, under "NON-DEPOSITORY," then on the "List of Active Check Cashers." If you have any questions regarding these licensees, please contact Administrative Specialist Sandra LeDoux (225) 922-0638 or by email at sledoux@ofi.louisiana.gov.

I want to let everyone know that Deputy Commissioner Doris Gunn's condition has improved, and she continues to undergo treatment for thyroid cancer. For those of you who know Doris, you know that she's strong, both mentally and physically. If you would like to keep up with her progress, her daughter, Kristi, has been keeping everyone informed of her condition through a blog, www.doris-report.blogspot.com. You may send messages through this blog site or I will see that she gets any messages or cards if sent to our office.

In closing, I also want to inform everyone that Deputy Chief Examiner Joe Gardner retired effective August 15, 2006, following 27 years of state service. I know you will join with me in wishing him the best in his retirement. I will be happy to forward any correspondence to Joe if you would like to contact him.

Please do not hesitate to contact me if you have any questions regarding the contents of this update. You may contact me at 225/925-4675 or by email at sseymour@ofi.louisiana.gov.